

# Annual Report

Fiscal Year 2002

## Washington State Liquor Control Board

Merritt D. Long  
Chairman

Vern Ing  
Board Member

Doger Elsen  
Board Member

Pat Kohler  
Administrative Director

### PLAINTIFF'S EXHIBIT

CASE  
NO. CV04-0360P

EXHIBIT  
NO. 013

V. Ing  
7  
DEP EXHIBIT  
CA. IN. GRANTE  
NOT A PUBLIC

4-25-05

## *From the Board*

We are pleased to present the Washington State Liquor Control Board 2002 annual report. This report covers the results of the agency operations for the period of July 1, 2001 through June 30, 2002.

Fiscal Year 2002 was filled with significant accomplishments for the agency. The first Alcohol Impact Area was implemented in the City of Tacoma, the Enforcement and Education Division received the National Liquor Law Enforcement Association's Liquor Enforcement Agency of the Year Award, and we created a new agency organizational structure to maximize efficiency.

The Liquor Control Board collected and distributed over \$217 million to state and local governments in Fiscal Year 2002. These dollars, collected from liquor taxes and license fees, go toward programs that provide important services to the state's taxpayers. For example, we distributed,

- \$118 million to the State General Fund
- \$36 million to the state's health care system
- \$9 million to violence reduction and drug enforcement programs.

We look forward to meeting the challenges of the next year. We want to thank our business partners for their support, and most importantly, thank the employees of the Liquor Control Board whose dedication and hard work make the results outlined in this annual report possible.

Sincerely,



Merritt D. Long  
Board Chairman



Vera Ing  
Board Member



Roger Hoen  
Board Member



The Washington State Liquor Control Board is a three-member Board appointed for six year terms by the Governor.

The Board's primary responsibility is to oversee the sale and distribution of alcohol beverages. This is accomplished through licensing, enforcement, education, and controlled distribution and merchandising systems.

The Board has over 12,000 liquor licensees throughout the state. Annually the agency's in-house licensing program processes over 3,000 license applications, investigates applicant background histories, provides technical assistance to liquor applicants, and monitors activities of manufacturers, importers, and wholesalers. The agency also has a Mandatory Alcohol Server Training (MAST) program that certifies over 170,000 bartenders, managers, and wait staff have been trained in how to check identification and signs of intoxication.

In conjunction with the agency licensing responsibilities, eighty-five Liquor Enforcement Agents located throughout the state enforce alcohol beverage and control laws. These agents are responsible to:

- Prevent liquor and tobacco law violations through technical assistance and education;
- Inspect all liquor licensed premises to ensure compliance with laws and regulations;
- Investigate all complaints;
- Conduct free education classes regarding liquor and tobacco laws, checking identification to prevent youth access, and recognizing the signs of intoxication;
- Deter the sale of untaxed cigarettes and enforcing tobacco tax regulations.

The agency is also responsible for alcohol awareness and education efforts, with the goals to:

- Develop and coordinate educational materials targeted to reduce underage drinking.
- Foster responsible behavior in adults who choose to drink alcohol.

The agency also controls the retail sale of spirits through 157 state owned and 155 contract liquor stores throughout the state. Annually, more than 5 million cases of liquor are procured, shipped and sold at retail through these stores.

## Accomplishments

### Board Members Move To 60% Working Hours

*"After 18 months of an Administrative Director managing the daily operations of the agency, we realized we could further maximize our managerial tasks and pursue greater efficiencies by adjusting the Board structure."* **Merritt Long, Chairman**



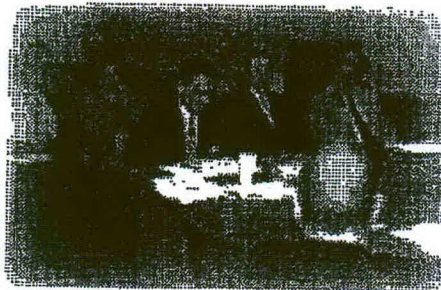
In December 2001, the three-member Liquor Control Board adopted a resolution to move to 60% working hours. This was a significant change in the agency management structure that had existed for over 66 years. After the creation of the position of Administrative Director in 1999 to oversee and manage the day-to-day operations of the agency, the three-member Board realized it could meet its statutory responsibilities at less than full time. Board Members are now able to focus on their primary responsibilities, namely policy, rules, legislative proposals, and their adjudicative responsibilities.

### Business Advisory Council Created

*"I appreciate the opportunity to have a regular forum to hear directly from Board Members concerning agency issues and direction. The Council provides an outlet for all stakeholders to exchange ideas, provide feedback, and work in partnership to achieve common goals."* **Gene Vosberg, President and CEO, Washington Restaurant Association**

When the Board moved to 60% working hours in 2002, they created a Business Advisory Council to ensure agency stakeholders would not have decreased access.

The Council provides an avenue for the Board to update customers and stakeholders about current issues, and for stakeholders to raise any issues with the Board. The Council, composed of 12 stakeholder groups, meets quarterly.



### First Alcohol Impact Area Is Implemented

*"This was a positive, collaborative effort among a state agency, local government, business community and a neighborhood resident group to address an important public health and public safety issue. Within the first six months of implementing the alcohol impact area, the community saw a significant change for the better." Officer Greg Hopkins, Community Liaison, Tacoma Police Department*

The Board instituted the state's first Alcohol Impact Area within the City of Tacoma in March 2002. Fifty-seven liquor licensees are now prohibited from selling certain high alcohol content/low cost beers and wines for off-premises consumption within the boundaries of the Alcohol Impact Area.

In 1997, communities experiencing problems with high concentrations of chronic public inebriates approached the Liquor Control Board asking for the agency's assistance. These communities cited a variety of behaviors and criminal activities linked to alcohol sales and consumption that were contributing to the deterioration of the quality of life within the neighborhood, and were disproportionately taxing public resources.

The Board created the Alcohol Impact Area rules in recognition of its statutory mandate to protect the public's health, peace, and safety and its responsibility to work with communities to help mitigate negative impacts associated with the sale of alcohol by the businesses it regulates.

## Liquor Enforcement Agency of the Year

*"Their programs create a collaborative atmosphere between the communities, local law enforcement and government and the educational systems. They build on the unique position of the liquor control agent to act as a catalyst between groups sharing common liquor management goals."* **Roger B. Johnson, President, National Liquor Law Enforcement Association**

The National Liquor Law Enforcement Association selected the Liquor Control Board's Enforcement and Education



Division as "Liquor Enforcement Agency of the Year." The Division was nominated in the "Innovative Programs" category because of their "Community Oriented Liquor and Tobacco Enforcement" and "Party Patrol" programs. Both programs encourage law enforcement and the public to work together towards a common goal of decreased alcohol access to minors and overservice.

## Distribution Center Increases Business Capacity

The Liquor Control Board's liquor distribution center was originally built in 1947. The decision to build a new facility came as the distribution center was facing facility repairs and updating expenses of more than \$6.5 million and shipping volumes twice the original



intent of the building. As part of the agency's plan to modernize the state's liquor retail system and distribution center, the original center was replaced with a new 160,000 square-foot facility on the existing Seattle site. Within the new distribution center is a computerized material handling system.

This software package, presently used in other industries, has been tailored to handle the 43 million units that annually pass through the facility.



## The Market Place

The following section is an overview of general market trends and conditions in Washington State that affect the Liquor Control Board's operations and how it meets the mission "to serve the public by preventing the misuse of alcohol and tobacco through controlled distribution, enforcement, and education; and provide excellent customer service by operating efficient, convenient retail stores."

### Economic Trends

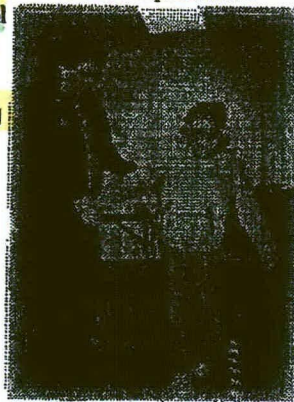
For the next three years, the Washington State Forecast Council has projected modest increases in retail sales. The state's economy affects Liquor Control Board operations in several ways, including the agency's operating budget and the impact of liquor sales trends on the retail operations and revenue production. However, a review of liquor sales in Washington shows that liquor sales generally hold steady during recessionary times.

### Alcohol Consumption

Market research indicates that while certain beverage alcohol product areas are showing growth, such as the wine market and premium brands, the overall consumption of alcohol has been declining since 1987. Factors affecting this trend include:

- Stricter legislation against drunk driving
- Stricter legislation against sales of alcohol to minors
- Interest in healthier lifestyles

Between 1987 and 1997, the Bureau of Labor Statistics reported the average annual consumer expenditures on alcohol beverages dropped 24%, from \$408 to \$309. However, some industry experts believe that this trend will start to change and take an upward swing in the next several years as the children of baby boomers reach drinking age, creating a "baby boom echo" effect.

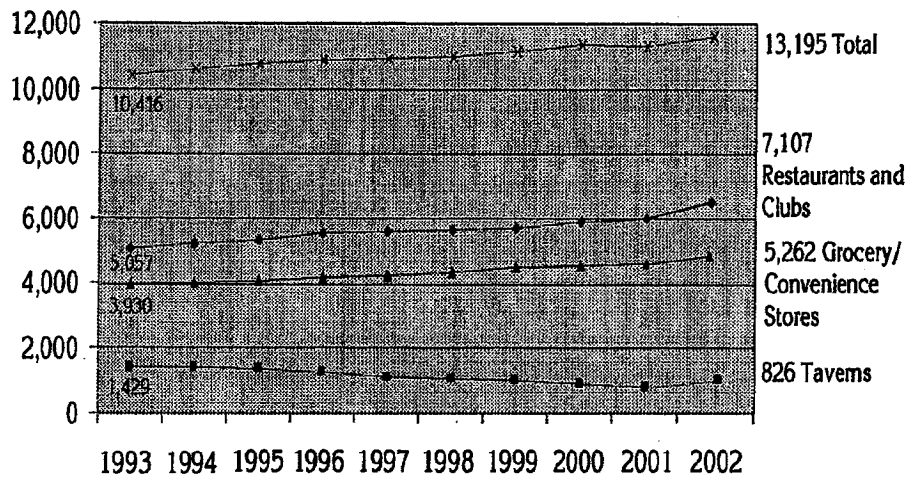


Agent Lisa Reinke provides assistance to Taylor Jolly who is wearing "Fatal Vision Goggles." The goggles impair the vision to simulate .08 or .1 blood alcohol content and demonstrate how alcohol impairs your ability to do the simplest of tasks such as walk a straight line.

## Drinking-age Population

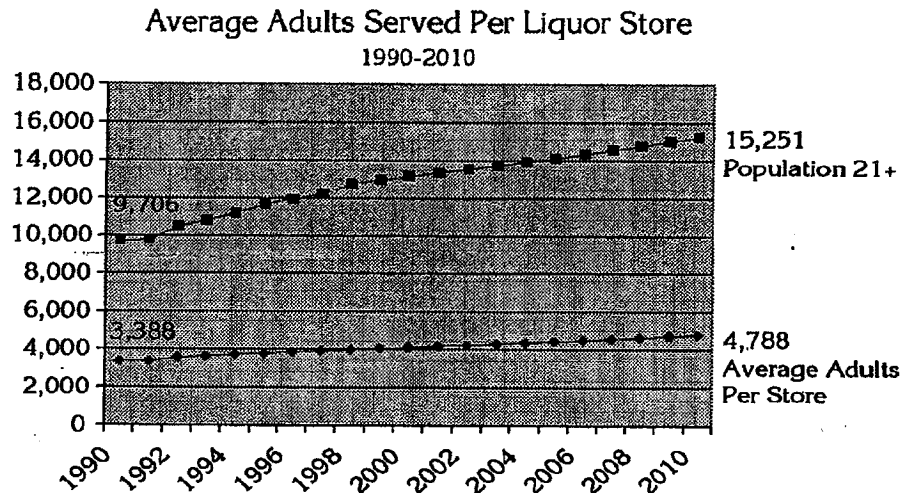
Projections indicate that the legal drinking-age population in Washington State will grow almost 20% between 2000 and 2014. The rise in the drinking-age population means an increase in the number of licensed premises (restaurants, bars, grocery stores, etc.), and an increase in the number of alcohol consumers who are recipients of the Liquor Control Board's education and enforcement efforts. The following chart shows the rise in the number of licensed premises that sell alcohol at retail—a 1.5% to 2% increase per year.

Number of Retail Licensees FY 1993-2001





A rising trend in the number of drinking-age adults also means the average number of adults and licensees served by each liquor store will continue to increase, as indicated in the following chart.



### Profits and Tax Collections Increase

Consistent with sales growth in state-run and contract liquor stores, there has also been growth in the amount of taxes collected and profits generated and distributed to the state general fund, local governments, and health care funds. Between 1992 and 2001, there was almost a 33% increase in revenue distributions. Of the eighteen control states [states that directly control the distribution and/or retail sale of spirits], Washington ranked third in the percentage of revenue distributed to state and local governments at 41.1% of gross sales. The chart below shows the taxes and revenue distribution for Fiscal Years 1993 through 2002.

**Taxes and Revenue Distribution-10 Year Comparison**  
(In millions of \$)

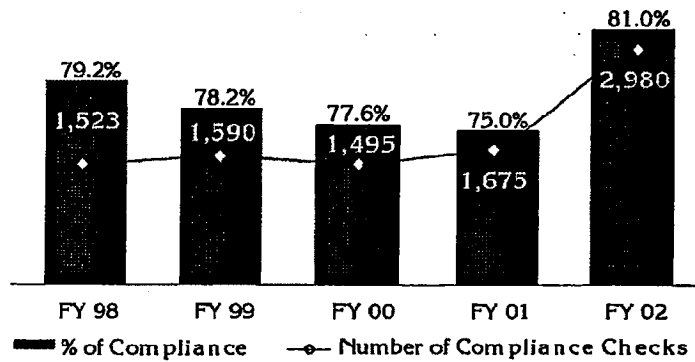
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Revenues distributed	62.1	65.5	61.3	65.3	65.6	77.2	80.7	75.7	79.2	86.4
Taxes distributed	92.3	97.5	95.8	99.4	102.9	107.0	115.8	122.2	127.7	132.1
Total distributed	154.4	163.0	157.1	164.7	168.5	184.2	196.5	197.9	206.9	218.5

## Enforcement

As the drinking-age population continues to grow, so do the number of licensed premises that sell alcohol at retail. This places continued demand on agency enforcement, training, and education efforts regarding liquor and tobacco laws.

The graph below shows the number of compliance checks conducted at licensed premises by Liquor and Tobacco Enforcement Agents for Fiscal Years 1998 to 2002, and the rate of compliance. The graph illustrates that licensees' rate of compliance with laws regarding sales to minors is tied to the number of compliance checks conducted by enforcement agents.

Total Compliance Checks Conducted and Compliance Rates



## Challenges

The Liquor Control Board (LCB) faces a number of challenges and opportunities. Some of the challenges the agency faces are as follows:

- New rules allowing a geographical area to be designated as an Alcohol Impact Area (AIA) went into effect in 1999. In December 2001, the first state-recognized AIA was designated in Tacoma, and the Board restricted the off-premises sale of 32 beer and wine products in the AIA. This restriction applies to approximately 56 Tacoma-area licensees. This effort places requirements on LCB for tracking, monitoring, and enforcing many frequently changing products and vendors. The LCB anticipates that more cities and towns will use the AIA approach and that each AIA will have a different list of banned products. As the AIAs grow statewide, the implementation of effective product restrictions will be an administrative challenge without the necessary technology tools and support.
- The consequences of excessive and underage drinking affect all college campuses, college communities and college students, whether they choose to drink or not. According to the National Institute on Alcohol Abuse and Alcoholism, each year 1,400 college students die from alcohol-related injuries, more than 600,000 students are assaulted, and 70,000 students are victims of alcohol-related sexual assaults or date rapes. The LCB's desire is to partner with college community coalitions that seek to change the availability of alcohol through focused prevention, in order to address problems such as binge drinking, keggers, shoplifting of alcohol, and use of fake identification.
- The Liquor Control Board enforces the Youth's Access to Tobacco law, which strictly regulates cigarette vending machines and businesses or individuals who provide tobacco samples. Tobacco advertising is very prevalent and affects all aspects of society. The current compliance rate is 89%, and the LCB intends to raise the compliance rate to 93% by June 2003.
- In January, 2002, the citizen initiative increasing both cigarette taxes as well as the taxes on other tobacco products presented a myriad of challenges. The cigarette taxes escalated from \$8.25 a carton to \$14.25 per carton. With the tax increase came a surge in cross border buying with Washington residents making purchases in both Oregon and Idaho where tax rates are far lower (\$6.80 in Oregon and \$2.80 in Idaho). Agents noted a substantial increase in people buying at Native American smoke



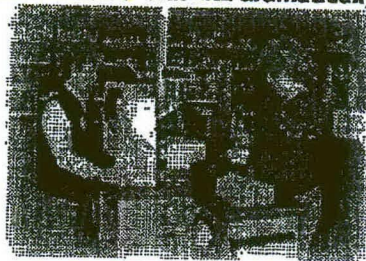
shops where no state cigarette taxes were being collected and ordering cigarettes via the Internet.

The tobacco tax enforcement program continued to work on the interdiction of contraband shipments, detect and seize counterfeit tax indicia at the retail level and conduct joint investigations with a variety of other agencies (both federal and state) to cope with the new challenges.

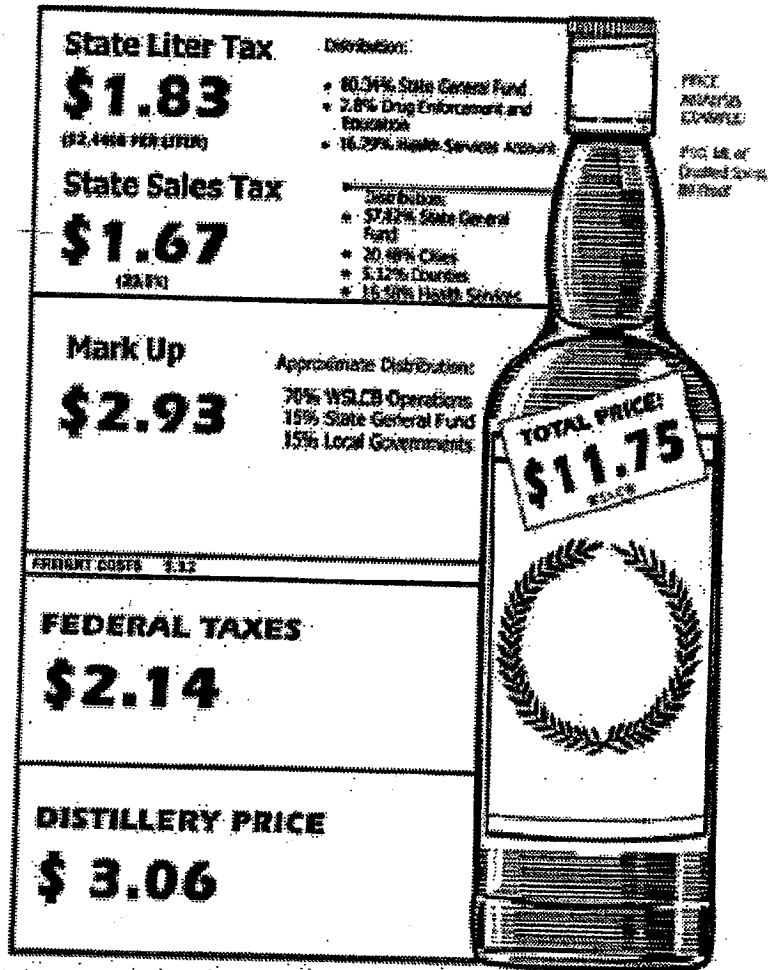
## Opportunities

The following are some of the agency's unique opportunities:

- The LCB's management team is focused on implementing best business practices and on continually evaluating and reviewing opportunities for improvements in agency operations.
- The LCB is in the process of implementing a new Merchandising Business System for state-operated stores. This will dramatically increase the type and availability of data of the state operation. Once functional, it will greatly improve the ability to manage store operations, purchasing, and distribution, using best business practices.
- Working through the development of skilled staff and securing enforcement credentials, the LCB has initiated the steps needed to achieve accreditation with the Commission on Accreditation for Law Enforcement Agencies. The collaboration involves the Criminal Justice Training Commission and the Washington State Police Chiefs and Sheriffs Association. Additionally, the LCB has become a member of the newly formed State Security and School Resource Association. Under this strategy, the LCB will gain an enhanced opportunity to partner with law enforcement and influence policy makers on alcohol-related issues.
- The new distribution center opened at its Seattle location in the spring of 2002 with a new automated material handling system. The material handling system is functioning and meeting its peak season daily shipping demands of 21,000 cases.



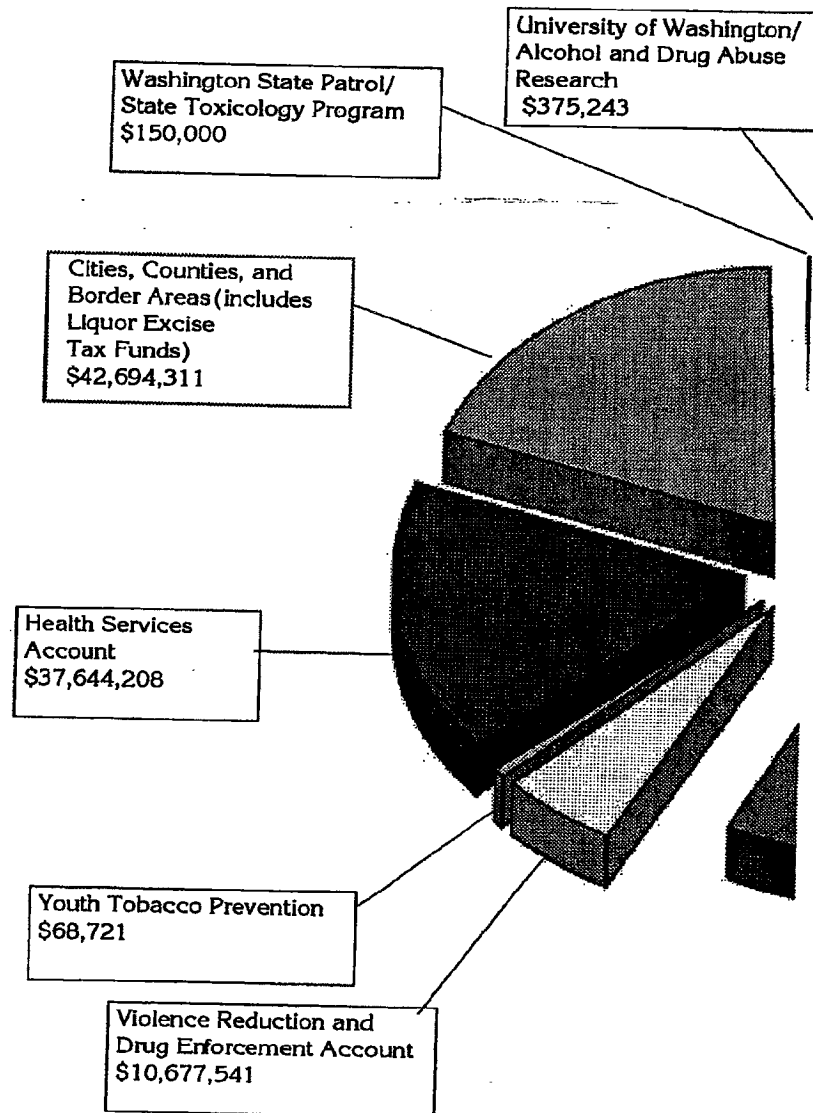
## What makes up the price of Liquor?



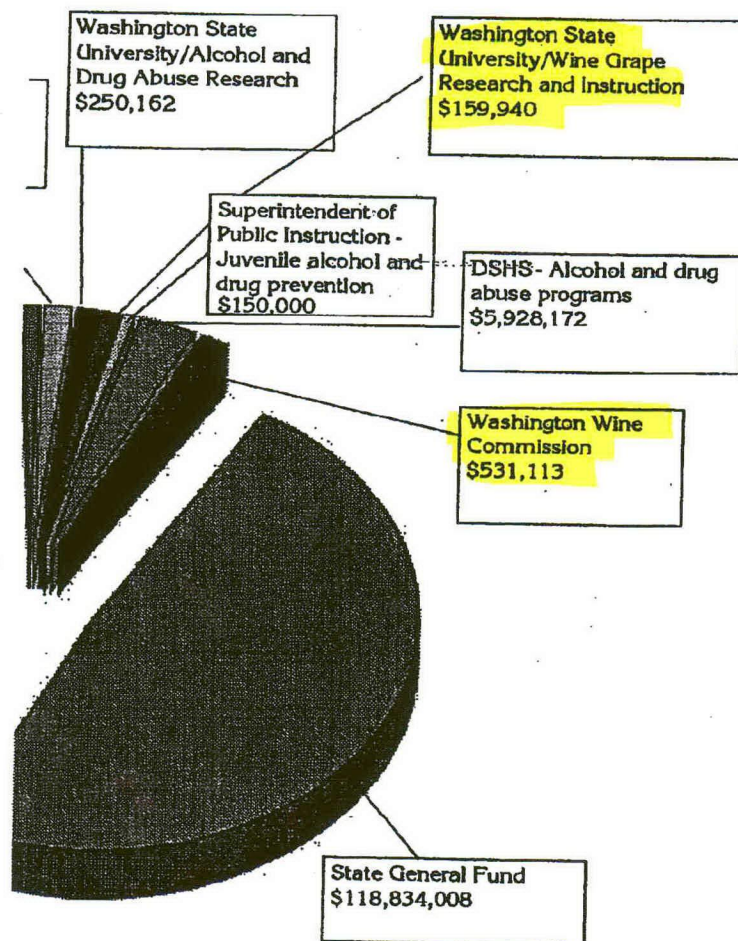
FEDERAL AND STATE TAXES AMOUNT TO \$5.64 OR 48.00 PERCENT OF THE \$11.75 TOTAL PRICE.

## Distribution of Revenues 2002

In addition to revenue generated to cities and counties, the Liquor Control Board also distributes revenue to a variety of other funds set by the Legislature. Between June 2001 and June 2002, \$217,463,419 was generated from liquor sale profits; taxes on spirits, beer, and wine; liquor license fees; and liquor and tobacco penalties. This chart shows the amount of revenue distributed to each fund.







## Washington State Liquor Control Board Comparative Income Statement

Fiscal Years Ended 6/30/02 And 6/30/01 (In Thousands)		2002	2001	Dollar Incr./ (Decr.)	Percent Incr./ (Decr.)
<b>Retail Operations</b>					
Liquor Sales Gross		\$531,695	\$508,916	22,779	4.48%
Less Discounts to Resellers		33,203	32,004	1,119	3.75%
Liquor Sales Excluding Discounts and Exempt Tax		\$498,492	\$476,912	21,580	4.52%
Less Sales Taxes and Surcharges		132,107	133,083	(976)	-0.73%
Less Wine Tax on Purchases		1,533	1,547	(14)	-0.90%
Liquor Sales Net		\$364,851	\$342,281	22,570	6.59%
Less Cost of Goods Sold		256,513	245,432	11,081	4.51%
Gross Profit on Sales		\$108,338	\$96,849	11,489	11.86%
Less Direct Sales Expense		45,541	44,554	987	2.22%
<b>Net Profit on Sales</b>		<b>\$62,797</b>	<b>\$52,295</b>	<b>10,502</b>	<b>20.08%</b>
<b>Revenue</b>					
Lottery Ticket Sales		159	161	(2)	-1.24%
Carrier Markup		155	203	(48)	-23.65%
Miscellaneous Income		107	72	35	48.61%
Net Profit before Other Expense Such as Agency Operations		\$63,218	\$52,731	10,487	19.89%
Other Expense Applicable to Merchandise Functions		19,759	20,350	(591)	2.90%
<b>Net Profit from Merchandise Function</b>		<b>\$43,459</b>	<b>\$32,381</b>	<b>11,078</b>	<b>34.21%</b>

### Number of Employees FY 2002

Salaried Employees:	592
Hourly:	679
<b>Total Employees:</b>	<b>1,271</b>

## Washington State Liquor Control Board Comparative Income Statement

Fiscal Years Ended 6/30/02 And 6/30/01 (In Thousands)	2002	2001	Dollar Incr./ (Decr.)	Percent Incr./ (Decr.)
<b>Other Revenue</b>				
License Fees & Penalties	\$9,323	\$8,205	1,118	13.63%
Beer Tax	29,113	28,663	450	1.57%
Wine Tax	15,396	15,400	(4)	-0.03%
Miscellaneous Income	43	319	(276)	-86.52%
<b>Total Revenue</b>	<b>\$53,875</b>	<b>\$52,587</b>	<b>1,288</b>	<b>2.45%</b>
Expense Applicable to Licensee & Enforcement Functions	10,960	11,634	(674)	-5.79%
<b>Net Revenue License &amp; Enforcement Functions</b>	<b>\$42,915</b>	<b>\$40,953</b>	<b>1,962</b>	<b>4.79%</b>
<b>Net Revenue</b>	<b>\$86,375</b>	<b>\$73,335</b>	<b>13,040</b>	<b>17.78%</b>
Sales Taxes and Surcharge	\$132,107	\$133,083	(976)	0.73%
<b>Net Revenue Plus Sales Taxes</b>	<b>\$218,482</b>	<b>\$206,418</b>	<b>12,064</b>	<b>5.84%</b>

The net revenue and sales taxes is generated from liquor sale profits; taxes on spirits, beer, and wine; liquor license fees; and liquor and tobacco penalties. All of the net revenue and sales taxes is distributed to a variety of funds as shown on page 15. This revenue helps pay for a multitude of state and local services.

### *Fiscal Year 2002 Facts*

*Total Liquor Sales: 531.6 Million*

*Total Revenue Distributed: 217.4 Million*

*Highest Store Sales: 12.3 Million (Seattle Store 101)*



# Washington State Liquor Control Board Five-Year Comparative Statement of Operations

	FY2002	FY2001	FY2000	FY1999	FY1998
<b>Retail Operations</b>					
Liquor Sales Gross	\$531,695	\$508,916	\$479,723	\$446,945	\$425,466
Less Discounts	33,203	32,004	29,481	27,217	26,188
Liquor Sales Excluding Discounts and Exempt Tax	\$498,492	\$476,912	\$450,242	\$419,728	\$399,278
Less Sales Taxes and Surcharges	132,107	133,083	122,175	115,847	110,529
Less Wine Tax on Purchases	1,533	1,547	1,608	1,626	1,569
Liquor Sales Net	\$364,851	\$342,281	\$326,459	\$302,255	\$287,180
Less Cost of Goods Sold	256,513	245,432	229,096	213,269	201,644
Gross Profit on Sales	\$108,338	\$96,849	\$97,363	\$88,986	\$85,536
Less Direct Sales Expense	45,541	44,554	42,737	43,534	40,828
<b>Net Profit on Sales</b>	<b>\$62,797</b>	<b>\$52,295</b>	<b>\$54,626</b>	<b>\$45,452</b>	<b>\$44,708</b>
<b>Revenue</b>					
Lottery Ticket Sales	159	161	176	164	156
Carrier Markup	155	203	166	166	167
Miscellaneous Income	107	72	338	35	125
Net Profit Before Other Expense Such as Agency Operations	\$63,218	\$52,731	\$55,306	\$45,817	\$45,156
Other Expense Applicable to Merchandise Functions	19,759	20,350	17,838	17,342	15,361
<b>Net Profit from Merchandise Function</b>	<b>\$43,459</b>	<b>\$32,381</b>	<b>\$37,468</b>	<b>\$28,475</b>	<b>\$29,795</b>

# Washington State Liquor Control Board Five-Year Comparative Statement of Operations

	FY2002	FY2001	FY2000	FY1999	FY1998
<b>Other Revenue</b>					
License Fees & Penalties	\$9,323	\$8,205	\$8,578	\$8,446	\$8,973
Beer Tax & Penalties	29,113	28,663	28,268	30,669	28,122
Wine Tax & Penalties	15,396	15,400	15,153	15,400	14,887
Miscellaneous Income	43	319	69	0	32
<b>Total Revenue</b>	<b>\$53,875</b>	<b>\$52,587</b>	<b>\$52,068</b>	<b>\$54,515</b>	<b>\$52,014</b>
Expense Applicable to License & Enforcement Functions	10,960	11,634	12,348	11,490	10,260
<b>Net Revenue License &amp; Enforcement Functions</b>	<b>\$42,915</b>	<b>\$40,953</b>	<b>\$39,720</b>	<b>\$43,025</b>	<b>\$41,754</b>
<b>Net Revenue</b>	<b>\$86,375</b>	<b>\$73,335</b>	<b>\$77,189</b>	<b>\$71,500</b>	<b>\$71,549</b>
<b>Sales Taxes and Surcharge</b>	<b>\$132,107</b>	<b>\$133,083</b>	<b>\$122,174</b>	<b>\$115,847</b>	<b>\$110,529</b>
<b>Net Revenue Plus Sales Taxes</b>	<b>\$218,482</b>	<b>\$206,418</b>	<b>\$199,363</b>	<b>\$187,347</b>	<b>\$182,078</b>

## WSLCB Total Revenue Generated (In millions of \$)

